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Supreme Court of the United States

OCTOBER TERM, 1941.

No. 867.

NATHAN HERZOG and EMANUEL HERZOG, Individually and as Co-partners, Trading as Columbia Pickle Works, Bankrupts,

Petitioners,

vs.

JACK DORMAN, Trustee,

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

BENJAMIN SIEGEL,
Attorney for Respondent.

SYDNEY BASIL LEVY,
Of Counsel.

THE COURT PRESS, N. Y. C.

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BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

Question Presented.

Should a discharge in bankruptcy be granted to a partnership whose business transactions were recorded without separation or identification in the books of a corporation similarly engaged?

The petitioners misstate the question presented, in that they assume as facts that they kept books and that such books were "honest".

Summary of Argument.

The bankrupts failed to keep books of account or records, from which their financial condition and business transactions might be ascertained, which failure was not justified under all of the circumstances.

No special or important reasons exist for certiorari.

The Facts.

The bankrupts were engaged in the business of selling food products to retailers and restaurants. The partnership business commenced in 1929 (fol. 222) and was known as The Columbia Pickle Works. In 1931, the partners formed a corporation known as the Columbia Pickle & Food Products, Inc. (fol. 171). Both businesses were located and operated from the same building in New York City (fol. 208).

On March 22, 1939, the bankrupts filed their petition for arrangement under Chapter XI of the Bankruptcy Act, in which proceedings they were later adjudicated bankrupts. On the same day, the corporation filed its own petition for arrangement, which likewise resulted in an adjudication. The total liabilities of the partnership as disclosed in the schedules, as amended, are $33,930.70, and the assets are listed in the sum of $5,540.78 (fol. 184).

At the hearing on the specifications, it was stipulated that none of the physical assets of the partnership were ever transferred, assigned or sold to the corporation; that the partnership made purchases of merchandise from its creditors; that the corporation made its own purchases; that only the partnership had a bank account which was used for both the partnership's and corporation's business affairs including payments for merchandise purchased by the corporation; that all of the accounts receivable created in the operation of both businesses were charged on the billheads of the corporation, although the partnership never assigned or transferred its accounts receivable to the corporation; and that the income from such accounts receivable were deposited in the partnership bank account (fols. 211, 213).

The partnership assigned accounts receivable as security to two of its creditors who were listed as secured by reason thereof (fols. 44, 45).

Some of the creditors of the partnership instituted actions against it prior to the filing of the petition for arrangement herein. Actions were also instituted against the corporation (fols. 174, 177).

The books of account turned over to the Trustee in Bankruptcy on behalf of the partnership, were all those of the corporation, with the exception of those relating to the bank account which was in the partnership name (fol. 227). The books date from 1934 (fol. 219) although the corporation was formed in 1931 (fol. 171). All prior records are missing (fol. 249).

The Trustee's accountant who had examined the corporation's books (fol. 215) could not determine therefrom the assets of the partnership, the assets of the corporation, the liabilities of the partnership, the liabilities of the corporation (fol. 241), or the partnership accounts receivable, income or disbursements (fol. 228).

The accountant could not ascertain the financial condition and business transactions of the partnership from the books (fol. 222), and added, that in the absence of oral comment, there was nothing in the books which would show that the obligations therein contained were other than those of the corporation (fol. 240).

There was only one accounts payable record and only one accounts receivable record and there was no distinction made, or any symbols or other indication used to indicate that certain of the accounts receivable or accounts payable were treated differently from others (fol. 247).

POINT I.

The bankrupts failed to keep books of account or records from which their financial condition and business transactions might be ascertained.

The bankrupts were engaged in the operation of a business in which they personally obtained credit, incurred liabilities and acquired assets (fols. 211-213).

Under the standard set up by the practice of the day, merchants, actively engaged in business, are required to keep intelligible books of account or records from which their true financial condition and business transactions might be ascertained. *In re Weisman* (D. C. N. Y.), 1 Fed. Supp. 723; *Matter of Smith* (D. C. N. J.), 13 Fed. Supp. 20. In *McKibbon* v. *Haskell* (C. C. A. 8), 198 Fed. 639, the Court stated:

> "The Act of Congress proclaims the presumption and expectation of the law that honest merchants will keep account books which will disclose their true financial condition."

The Court, in *In re Hanna* (C. C. A. 2), 108 Fed. 238, held that Section 14 of the Bankruptcy Act intended to insure the keeping of correct and complete accounts and should be rigidly enforced.

The bankrupts did not keep separate books of account or records pertaining to the partnership's business.

The primary purpose of the Bankruptcy Act is the collection and distribution of the bankrupt's estate to creditors. *Williams* v. *U. S. Fidelity Co.*, 236 U. S. 549, 35 S. Ct. 289, 59 L. ed. 713. In this case, it is impossible to effectuate this purpose, since there is

nothing to indicate the partnership's liabilities and assets, as distinguished from those of the corporation.

Books and records are material to a proper administration of bankrupt estates for a number of reasons. They are required so that they may be checked against the oral statements or explanations made by bankrupt. *Matter of Underhill* (C. C. A. 2), 82 Fed. (2) 258. They are necessary to ascertain the dates of insolvency, important in connection with preferential and fraudulent transfers, if any. They are required to serve as a check against unfounded or fictitious claims of alleged creditors; to ascertain whether financial statements issued by the bankrupts are true or false; and to check in detail the disposition of the bankrupt's assets. In the absence of intelligible records, it is impossible for creditors to judge a bankrupt's true financial condition and determine whether the bankruptcy was an honest failure caused by business reverses, or an attempt to escape liability without surrender of property. *In re Magen Bros.* (C. C. A. 3), 192 Fed. 883; *Matter of Smith* (D. C. N. J.), 13 Fed. Supp. 20.

In *Matter of Underhill* (*supra*), 82 F. (2) 258, 31 A. B. R. (N. S.) 57, 60, the Court stated:

> "Complete disclosure is in every case a condition precedent to the granting of the discharge, and if such a disclosure is not possible without the keeping of books or records, then the absence of such amounts to that failure to which the Act applies. *Nix* v. *Sternberg, supra; Karger* v. *Sandler* (C. C. A., 2d Cir.), 22 Am. B. R. (N. S.) 423, 62 F. (2d) 80; *In re Miller* (D. C., Md.), 25 Am. B. R. (N. S.) 558, 5 F. Supp. 913 * * *.
>
> "The purpose and intent of section 14b of the Bankruptcy Act is to make the privilege of

discharge dependent on a true presentation of the debtor's financial affairs. It was never intended that a bankrupt, after failure, should be excused from his indebtedness without showing an honest effort to reflect his entire business and not a part merely. To be sure, there may be records which are not books; but it is intended that there be available written evidence made and preserved from which the present financial condition of the bankrupt, and his business transactions for a reasonable period in the past may be ascertained. Records of substantial completeness and accuracy are required so that they may be checked against the mere oral statement or explanations made by the bankrupt. See *International Shoe Co.* v. *Lewine* (C. C. A., 5th Cir.), 24 Am. B. R. (N. S.) 246, 68 F. (2d) 517, 518."

The Court, in *Matter of Weiner* (D. C. Md.), 28 F. (2d) 881, 12 Am. B. R. (N. S.) 651, 653, stated:

"It is true that for a number of years past the bankrupt appears to have kept books in this same manner. It is further true that there is no iron clad rule under the Bankruptcy Act requiring the keeping of any books. That is to say, a business may be so small that the total absence of them may be justified. Similarly, if books are kept, there is no particular form of accounting that need be followed. On the other hand, the election to keep them implies that they, if not by themselves, then in conjunction with other less formal records, shall *prima facie* give every evidence of an honest effort to reflect the entire business of the bankrupt. As long as there is any doubt on this point a court of bankruptcy should resolve that doubt for the benefit of creditors. A discharge is a privilege granted by the Act.

One who seeks thereby to avoid his debts must comply strictly with its provisions."

See also

Matter of Northridge (D. C. N. Y.), 53 F. (2) 858.

The objecting trustee met and discharged the burden of showing to the satisfaction of the Court that there were reasonable grounds for believing that the bankrupts failed to keep books of account or records from which their financial condition and business transactions could be ascertained. The burden then shifted to the bankrupts of showing that such failure was justified under all the circumstances of the case. Section 14 (c) Bankruptcy Act; *Karger* v. *Sandler* (C. C. A. 2), 62 F. (2) 80; *Nix* v. *Sternberg* (C. C. A. 8), 38 F. (2) 611.

POINT II.

The failure to keep books of account or records was not justified under all of the circumstances.

The Bankrupts' attempt to show justification was based upon the testimony of two witnesses. Their accountant since April or May, 1935 (fol. 287), stated that as far as he was concerned the corporation was the only identity (fol. 294), although the bank account was maintained in the name of the partnership (fol. 295). He stated that it was impossible to state from the books, with respect to the accounts payable, what was charged by creditors against the partnership and what was charged against the corporation (fol. 299). He could not state from these books the

extent of the partnership or corporate business (fol. 307).

The bookkeeping system employed by the bankrupts was highly objectionable to this accountant, who, in 1935, by letters, "insisted strongly that they should straighten the whole matter out" (fol. 299).

The bankrupts also produced their manager who had been in charge of the books for many years (fol. 329). This witness did the purchasing for both the partnership and corporation, but "the partnership was mostly buying merchandise, because they had the credit" (fol. 344). Even this witness could not state the amount and extent of the respective purchases made by the partnership or by the corporation (fol. 345).

The bankrupts offered no explanation for their failure either to keep a separate set of books or records or of their failure to separate or identify, in any form, their liabilities, assets or business transactions in the corporation's books. They did not urge that they kept a file of their bills payable. They made no attempt, during the course of the hearings to indicate from the books or records any information therein contained which would indicate their financial condition and business transactions.

The failure to keep books and records which are customarily kept by merchants called for an explanation but none was forthcoming. It is impossible to obtain any fair or proper understanding of the bankrupts' business transactions before the bankruptcy. *Matter of Krulewitch* (D. C. N. J.), 60 F. (2) 1039.

They could make no pretense of ignorance of the condition of the books since they had been warned

in writing by their own accountant as far back as 1935 that their bookkeeping system was highly objectionable and should be straightened out (fol. 299). The bankrupts were properly chargeable with intending the natural and probable consequences of their omissions. *Matter of Janavitz* (C. C. A. 3), 219 Fed. 876.

Concededly, under Section 14, no formal books of account need be kept, nor is any particular form of books required, nor is it necessary that books as distinguished from records be kept. Full details of all of the bankrupts' transactions need not be stated, if they are so identified that inquiry can be made about them. Further, the keeping of records of separate enterprises in the same set of books, is unobjectionable if the books separate or differentiate the transactions of the separate businesses (R. 135); *White* v. *Schoenfeld* (C. C. A. 2), 117 F. (2) 131.

All that is required, is that there be available substantially complete and accurate written evidence from which the bankrupts' business transactions and financial condition might be ascertained. *Matter of Underhill, supra,* 82 F. (2) 258.

Petitioners contend that from its inception, the corporation was the only entity which conducted business. This contention disregards the fact that the partnership and the corporation separately continued to obtain credit and make purchases, and the fact that both the partnership and the corporation were being sued separately by their respective creditors at the time of the filing of the petitions for arrangement (fol. 177). There was a real confusion as to what entity was liable (fols. 239, 240).

Petitioners contend that, in any event, since all of the partnership activities were reflected in the corporation's books, there was a sufficient groundwork therein contained to enable an outside investigation to determine the assets and liabilities of the partnership. The wording of Section 14, however, specifically provides for books or records "*from which*" the financial condition and business transactions might be ascertained. *Matter of Smith (supra)*, 13 F. Supp. 20; *Matter of Weiner (supra)*, 28 F. (2) 881. In any event, the bankrupts failed to sustain the burden of going forward with the evidence to prove that an outside investigation would have disclosed the liabilities, assets, and disposition of assets.

Petitioners rely upon *International Shoe Co.* v. *Lewine,* 68 F. (2) 517, and *Hedges* v. *Bushnell,* 106 F. (2) 979, where the Courts held that it is enough if the books or records sufficiently identify the transactions so that intelligent inquiry can be made respecting them. But in those cases and in *In re Livermore,* 96 F. (2d) 93; and in *In re Marcus,* 203 F. 29, also cited by petitioners, the books or records were exclusively those of the bankrupts and the entries therein contained related solely to and were identified only with the bankrupts' businesses. This is not true in the case at bar.

Petitioners contend that they were entitled to a discharge since their honesty was "conceded". There was no such concession. There was no finding of honesty by the Referee before whom the issues were tried, and who had the jurisdiction to grant or deny the discharge. Section 38 (4) Bankruptcy Act. In the absence of books and records, it is impossible to arrive at this conclusion.

However, honesty alone is not sufficient justification for failure to keep books or records. There is nothing in the Bankruptcy Act, nor are there any decisions, to the effect that an "honest" bankrupt is excused from keeping books or records. No authority is cited for the statement in petitioners' brief, that "before discharge will be denied it is necessary that there be a showing of some design to cover up or conceal information, the furnishing of which would disclose assets" (p. 11).

There is no conflict between the holdings of the Circuit Court in the case at bar, and in *In re Lovich*, 117 F. (2) 612. In the latter case, the objection to discharge charged the commission of an offense punishable by imprisonment, by the making of a false oath as to the denial of the issuance of a financial statement. Books or records were not involved. The proof disclosed that a financial statement signed by the bankrupt's manager had been issued without the bankrupt's knowledge.

The other cases cited in Point III of petitioners' brief are inapplicable. *In re Marcus* (*supra*), 203 F. 29, the only objection was that the bankrupt's books did not contain a yearly inventory. *In re Livermore* (*supra*), 96 F. (2) 93, the incorrect entry in the bankrupt's books was made while the bankrupt was in Europe, and without his knowledge. Neither case presented the factual situation under consideration in the case at bar.

It is respectfully submitted that under all the circumstances there was no justification for the failure of the bankrupts to keep books of account or records from which their financial condition and business transactions might be ascertained.

POINT III.

No special or important reasons exist for certiorari.

The decision of the Circuit Court of Appeals is not in conflict with the decisions of other Circuits. The decisions of the other Circuit Courts do not pass upon the question presented in the case at bar (Point II, *supra*).

The decision of the Circuit Court of Appeals is not in conflict with its previous decision in *In re Lovich* (*supra*), 117 F. (2) 612, where, as heretofore stated, an entirely different question was presented for consideration (Point II, *supra*).

The decision of the Circuit Court of Appeals is of limited application, due to the unusual facts presented, and is not of general importance.

CONCLUSION.

It is respectfully submitted that the petitioners have shown no reason for granting their petition for certiorari and the petition should be dismissed.

Respectfully submitted,

BENJAMIN SIEGEL,
Attorney for Respondent.

SYDNEY BASIL LEVY,
Of Counsel.